LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

301 State House
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FISCAL IMPACT STATEMENT

LS 6303 **DATE PREPARED:** Dec 11, 2000
BILL NUMBER: HB 1193 **BILL AMENDED:**

SUBJECT: Health Insurance for Retired State Employees.

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FUNDS AFFECTED: **X** **GENERAL** **IMPACT:** State
DEDICATED
FEDERAL

Summary of Legislation: The bill requires that group health insurance provided to retired state employees who meet certain requirements (including that they are at least 55 years of age and are not Medicare eligible) be equal to that offered to active state employees. The bill permits the retired state employee to participate in the group health insurance program at the same premium as an active state employee. (Under current law, retired state employees must pay the entire cost of the health insurance coverage.) The bill requires the state to pay the employer's share of the health insurance premium for participating retired state employees. The bill also authorizes the state to elect to pay any part of the retired employee's share of the premium.

Effective Date: July 1, 2001.

Explanation of State Expenditures: ***Fiscal Impact:*** The net cost to the state of this proposal is estimated to fall between $1 M and $7 M annually. The methodology used to produce this estimate along with background information is described below.

Background: The net fiscal impact of this proposal is due to the costs associated with the major population components described below and depicted in the table.

Group A : This group consists of retired state employees who are currently on the state health plan. The cost to the state for Group A (as described in the upper-left cell of the table) is the most straight forward of the several employee groups to estimate. There are about 331 retired state employees in this group, about 84% of whom are on single coverage and 16% of whom are on family coverage. The additional cost to the state as a result of this proposal is the employer portion of the total premium that is currently being paid by the retiree but would now be paid by the state. The weighted average of this cost is estimated to be about $3,310 per year per employee resulting in an additional total cost for this group of about $1.1 M.

<table>
<tr><th></th><th>Currently on Health Plan</th><th>Currently NOT on Health Plan (but would go on health plan due to lower cost of insurance)</th></tr>
<tr><td>Currently Retired</td><td>A.

(1) No. of individuals
(2) Employer share of annual costs of health plans

♋ State $'s for health plans ♒</td><td>B.

(1) No. of individuals responding to effective decrease in price of health plan
(2) Total health cost of individual less the employee contribution (could involve some adverse experience factor)

♋ State $'s for health plans ♒</td></tr>
<tr><td rowspan="2">Currently NOT Retired (but would retire with lower cost of health insurance)</td><td>C. Retiree replaced by new hire:

(1) No. of new hires
(2) Employer share of annual costs of health plans
(3) Difference in salary and salary-based benefits

♋ State $'s for health plans ♒
♋ State $'s for salary costs ♓
♋ Pension costs (?)</td><td rowspan="2">E.

Minimal Impact from this group.</td></tr>
<tr><td>D. Retiree NOT replaced by new hire:

(1) No. of new retirees
(2) Salary costs of retirees

♋ State $'s for health plans - No Change
♋ State $'s for salary costs ♓♓
♋ Pension costs (?)</td></tr>
</table>

Group B: This group consists of retired state employees who <u>are</u> <u>not</u> currently on the state health plan, but would have an increased incentive to participate in the state health plan under the provisions of the bill. There are about 11,432 retired state employees. Of these, about 9,901 are over 65 years of age. This results in an estimated 1,531 retirees under the age of 65. Of the 1,531 retirees, about 331 (Group A) are currently on the state health plan. This leaves 1,200 retirees who are currently not on the state health plan but will now see a significantly reduced price for health insurance: from 100% of the annual premium to 6.5% of the annual premium with this proposal. This represents a significant price decrease and would provide a substantial incentive for the retiree to now participate in the state health plan.

The cost to the state for each of these individuals, however, is not necessarily merely 93.5% of the average premium (the usual employer portion of the premium). This group, since they are newly covered and being older than the average state employee, may cost more to provide health benefits to than the average employee. The state would be responsible for the total claims costs for this group less the total amount of premium (employee share) contributed by the group. However, since this group is not currently on the health plan, the claims costs of this group are not known. An upper limit can be estimated based on the claims expenditures of Group A, described above. Group A has an adverse experience factor in that Group A has

about $2.37 in claims expenditure for every dollar of claims expenditure experienced by the state employee group as a whole. Consequently, the 1,200 individuals that might now choose to participate in the health plans may cost the state $10.1 M with an employee contribution of $0.3 M. The net cost to the state of Group B would be $9.8 M by this estimate.

However, this probably overestimates the cost of this group. The retired employees that currently choose to pay both the employee and the employer share of the premium to participate in the state health plan (Group A) is probably a high cost group. Group A represents about 22% of the state employee early retirees -- the Congressional Budget Office estimates that 25% of the population accounts for about 90% of health spending. Consequently, using the claims experience of Group A probably significantly overestimates the probable costs of the other 78% of the early retiree population that has previously chosen not to purchase state health insurance. Assuming an estimated claims expenditure equivalent to the state employee population as a whole and assuming only a 90% participation rate (since all employees may not choose to participate even at the lower price) results in estimated net cost to the state of about $4 M. This represents a lower bound.

The net cost to the state of Group B is expected to fall somewhere between $4 M and $10 M.

Group C: This group consists of active state employees who are currently on the state health plan and who retire early and are replaced by newly hired employees. These active state employees are eligible for early retirement and, because of the provisions of the bill, perceive the cost of retirement to have decreased enough to retire while remaining on the health plan. The cost estimate, however, must include the cost related to the new employees hired as replacements as well as the cost related to the retiring employees.

The additional cost to the state for Group C is represented by the number of new replacement employees times the difference between the cost of providing health coverage and the employee contribution. Based on an experience study by the actuaries for the Public Employees' Retirement Fund (PERF), about 10% of those individuals eligible for retirement each year actually retire. With the reduced costs of health insurance offered in this proposal, the actuaries estimated that about 18% of those individuals eligible would retire early. This is estimated to represent about 676 new retirees resulting in about $2.2 M in additional costs for health care. (These costs may be overstated to the extent that replacement employees would likely be younger and have lower claims expenditures than the average employee.) The health costs borne by the state would not change for the retiree.

Lower salary and salary-related expenditures could potentially offset the higher health benefit costs borne by the state because a new replacement employee would likely receive a lower salary, and would incur lower salary-related expenditures, as well. An average reduction in annual salary is estimated to be $8,000 with 19.56% in salary-related fringe benefits (i.e., life insurance, social security, PERF contributions, and disability insurance) and would result in a cost reduction of about $6.4 M. The resulting net reduction in health and salary costs for this group is estimated to be about $4.2 M (i.e., $6.4 M less $2.2 M).

There could also be some impact on pension costs resulting from a lower pension contribution for the new employee and earlier payout of pension benefits for the retiree. However, this has not been estimated at this time.

Group D: This group consists of active state employees who are currently on the state health plan and who retire early but <u>are not</u> replaced by newly hired employees. These active state employees are eligible for early retirement and, because of the provisions of the bill, perceive the cost of retirement to have decreased enough

to retire while remaining on the health plan.

Although it is possible that retiring employees are not replaced, for the purposes of this analysis, it is assumed that all employees are replaced. However, to the extent that a retiree is not replaced, there would be no change in health care costs borne by the state. In addition, there would be a reduction in salary and salary-related fringe benefits associated with the retiring employee. Upon an employee's retirement, the state's pension contributions would stop. However, pension benefit payments would begin earlier than they would if the employee did not retire. The impact of this group is assumed to be minimal.

Group E: This group consists of active state employees who are not currently on the state health plan and who are eligible for early retirement.

This group of active employees does not currently purchase coverage under the state employee health plans, even under the provision that the active employee contribute only about 6.5% of the insurance premium. Consequently, it is assumed that reducing the cost of insurance for retirees would not provide sufficient incentive to result in major shifts of such employees into retirement status. The impact of this group is also assumed to be minimal.

Summary: The order of magnitude for the total impact of this proposal is estimated to fall between $1 M and $7 M. This is based on the individual impacts associated with the following components:

Employee Group	Low Estimate	High Estimate
Group A	$1.1 M	$1.1 M
Group B	$4.0 M	$9.8 M
Group C	($4.2 M)	($4.2 M)
Group D	minimal	minimal
Group E	minimal	minimal
Total	$0.9 M	$6.7 M

Explanation of State Revenues:

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: All.

Local Agencies Affected:

Information Sources: Keith Beesley, State Department of Personnel, 232-3062; Doug Todd of McCready & Keene, Inc., actuaries for the Public Employees' Retirement Fund, 576-1508.